

## Message Text

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PASS CEA, TREASURY, FRB

E.O. 11652: N/A

TAGS: ECON, OECD

SUBJ: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC)

REVIEW OF NEW ZEALAND, JUNE 24, 1976

REFS: (A) EDR(76)14, (B) STATE 154743

1. SUMMARY: AT JUNE 24 EDRC REVIEW DIFFERENCES BETWEEN NEW ZEALAND AND SECRETARIAT FORECASTS OF SHORT-TERM NZ OUTLOOK WERE MINIMAL. DISCUSSION FOCUSED ON CAUSES OF PRESENT LARGE CURRENT ACCOUNT DEFICIT, PROSPECTIVE EVOLUTION OF DEFICIT IN SHORT AND MEDIUM TERM, AND EXTERNAL FINANCING PROBLEMS THAT MIGHT BE ENCOUNTERED. NZ DEL (TERRY, TREASURY) COMPLAINED THAT THEIR PRESENT EXTERNAL SITUATION WAS AGGRAVATED BY ECONOMICALLY STRONGER OECD COUNTRIES WHICH HAD SUCCEEDED IN FORCING WEAKER COUNTRIES TO BEAR BURDEN OF ADJUSTMENT TO OPEC CURRENT ACCOUNT SURPLUS. NZ ALSO CITED TRADE RESTRICT-

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TIONS AGAINST AGRICULTURAL PRODUCTS AS MAIN FACTOR LIMIT-

ING FUTURE GROWTH OF NZ EXPORTS AND INHIBITING NZ ABILITY TO MEET ITS EXTERNAL DEBT OBLIGATIONS. NZ FELT THAT IMPORT DEPOSIT SCHEME HAD BEEN SUCCESSFUL IN ACHIEVING ITS PRIME OBJECTIVE OF DAMPENING OF SPECULATIVE IMPORTS. IN NZ VIEW, SECRETARIAT CRITICISM THAT SCHEME HAD LITTLE EFFECT IN LIMITING TOTAL IMPORTS THUS NOT JUSTIFIED. (REVISED DRAFT SURVEY HAS BEEN MODIFIED TO TAKE NZ VIEWS INTO ACCOUNT.) EDRC AGREED WITH NZ THAT VARIOUS DOMESTIC STABILIZATION MEASURES (E.G. WAGE/PRICE CONTROLS, DEMAND MANAGEMENT RESTRAINT, PROGRAMS TO REDUCE VARIABILITY OF AGRICULTURAL INCOMES) WOULD HAVE POSITIVE EFFECTS IN SHORT AND MEDIUM TERM. EDRC ALSO EMPHASIZED THAT CENTRAL NZ POLICY OBJECTIVE SHOULD BE REDUCTION OF CURRENT ACCOUNT DEFICIT. END SUMMARY.

2. SHORT-TERM PROSPECTS: CURRENT ACCOUNT: NZ CURRENT ACCOUNT DEFICIT REACHED US\$1.46 BILLION IN 1975. FINANCING OF DEFICIT BROUGHT VOLUME OF EXTERNAL DEBT TO 18 PERCENT OF GNP AND DEBT SERVICE BURDEN TO 5-6 PERCENT OF TOTAL FOREIGN EXCHANGE RECEIPTS. NZ STRESSED THAT MAIN REASON FOR FRAMATIC INCREASE IN CURRENT ACCOUNT DEFICIT WAS MASSIVE (40-50 PERCENT) DETERIORATION IN NZ TERMS OF TRADE DURING 1974-75 RECESSION. NZ NOTED HISTORICAL TENDENCY OF CURRENT ACCOUNT POSITION TO WORSEN IN DOWNSWING AND TO IMPROVE IN UPSWING. THEY STATED THAT WHILE NET DEFICIT OVER CYCLE WAS NORMAL, LONG-TERM PRIVATE CAPITAL INFLOWS HAD BEEN SUFFICIENT TO PLUG GAP SO THAT NET OFFICIAL BORROWING (POSITIVE IN DOWNSWING, NEGATIVE IN UPSWING), WAS NEAR ZERO. HOWEVER, THEY STRESSED THAT IN CONTRAST TO THEIR PREVIOUS EXPERIENCE DRAMATIC INCREASES IN PRICES OF MANUFACTURED IMPORTS IN RECENT CYCLE HAD AGGRAVATED TERMS OF TRADE DECLINE DURING RECESSION AND HAD LIMITED THEIR IMPROVEMENT IN PRESENT RECOVERY, WITH RESULT THAT NET CURRENT ACCOUNT DEFICIT OVER CYCLE VASTLY EXCEEDED LONG-TERM PRIVATE CAPITAL INFLOWS AND HAD THUS LED TO HEAVY RELIANCE ON OFFICIAL BORROWING AND TO SIGNIFICANT INCREASE IN SHORT-TERM PRIVATE CAPITAL. NZ EXPRESSED PESSIMISM CONCERNING THEIR ABILITY TO MEET EXTERNAL DEBT OBLIGATIONS, PARTICULARLY IF CURRENT ACCOUNT HAS UNDERGONE STRUCTURAL LIMITED OFFICIAL USE

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DETERIORATION (SEE PARA 3 BELOW).

3. NZ EXPECTS CURRENT ACCOUNT DEFICIT TO FALL TO ABOUT US\$700 MILLION IN 1976 AND TO ANNUAL RATE OF US\$400-500 MILLION BY MID-1977. (SECRETARIAT PROJECTS DEFICITS OF \$750 MILLION IN BOTH TIME PERIODS.) HOWEVER, NZ HYPOTHESIZED THAT A STRUCTURAL DECLINE IN THEIR TERMS OF TRADE AND IN FUTURE GROWTH OF EXPORTS MAY HAVE TAKEN

PLACE. THEY IDENTIFIED EC IMPORT RESTRICTIONS ON AGRICULTURAL PRODUCTS AS MAIN FACTOR LIMITING EXPORT GROWTH. (U.S. VOLUNTARY RESTRAINT PROGRAM FOR MEAT IMPORTS WAS CITED AS A SECOND-ORDER CULPRIT.) NZ COMPLAINED THAT THEIR EXPORTS WERE BEING "INEXORABLY SQUEEZED OUT OF EEC MARKETS," AND REMARKED RATHER CAUSTICALLY THAT "CERTAIN" OECD COUNTRIES SHOULD "PRACTICE WHAT THEY PREACH" IN TRADE PLEDGE. NZ ALSO STRESSED THAT FOLLOWING OIL PRICE INCREASE, STRONGER OECD COUNTRIES HAD BEEN ABLE, BECAUSE OF MARKET POWER, TO PASS ON OIL-INDUCED COST INCREASES, THEREBY PUSHING THE BURDEN OF CURRENT ACCOUNT DEFICITS ONTO THE WEAKER COUNTRIES, MOST OF WHICH ARE PRICE TAKERS (SHADES OF RAUL PREBISCH). THUS, NZ CONCLUDED THAT DECLINE IN THEIR TERMS OF TRADE ALSO HAD STRUCTURAL COMPONENT. (SECRETARIAT NOTED THAT THE TWO DEVALUATIONS OF NZ DOLLAR HAD INCREASED IMPORT PRICES BY 27-28 PERCENT.) EDRC (WITH EXCEPTION OF JAPANESE) SUPPORTED NZ REITERATION OF MINISTERIAL CONCLUSION THAT STRONGER OECD COUNTRIES SHOULD BE WILLING TO ACCEPT CURRENT ACCOUNT DEFICITS AS LONG AS OPEC RUNS SURPLUS. THERE WAS LITTLE SYMPATHY, HOWEVER, FOR NZ VIEW THAT STRONGER COUNTRIES SHOULD GROW FASTER TO HELP REDRESS WEAKER COUNTRIES' CURRENT ACCOUNT POSITIONS. SECRETARIAT POINTED OUT THAT ACCELERATION OF INFLATION, WHICH WOULD RESULT FROM FASTER GROWTH IN STRONG COUNTRIES, WOULD ADVERSELY AFFECT NZ TERMS OF TRADE. NZ RESPONDED THAT INFLATION BY-PRODUCT OF MORE RAPID GROWTH COULD BE AVOIDED THROUGH INCOMES POLICIES.

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4. NZ AGREED WITH SECRETARIAT THAT EXPORT GROWTH POTENTIAL COULD BE IMPROVED THROUGH PRODUCT DIVERSIFICATION, AND NOTED THAT SHARE OF MANUFACTURES IN TOTAL EXPORTS HAD INCREASED FROM 3 PERCENT TO 14 PERCENT BETWEEN 1967 AND 1975. THEY COMMENTED, HOWEVER, THAT DIVERSIFICATION WAS A SLOW, EXPENSIVE PROCESS AND HAT, IN ANY CASE, NZ COMPARATIVE ADVANTAGE LAY IN AGRICULTURAL PRODUCTS.

5. SECRETARIAT ANALYSIS REFDON CONCLUDED THAT IMPORT DESPOSIT SCHEME HAD BROUGHT ABOUT MINIMAL (0.5 PERCENT) REDUCTION IN IMPORTS AND THAT DOMESTIC LIQUIDITY EFFECTS COULD HAVE BEEN MORE EFFICIENTLY ACHIEVED BY OTHER MEANS. NZ ARGUED THAT PURPOSE OF SCHEME WAS TO DAMPEN SPECULATIVE IMPORT PURCHASES WHICH HAD ACCELERATED IN ANTICIPATION OF DEVALUATION AND/OR IMPOSITION OF IMPORT QUOTAS. THEY SAID THAT SCHEME HAD EFFECTIVELY CURBED SPECULATION AND HAD MET FURTHER OBJECTIVE OF MINIMIZING ADVERSE EFFECT ON NZ'S TRADING PARTNERS. (REVISED DRAFT SURVEY TAKES INTO ACCOUNT NZ VIEWS CONCERNING PURPOSE AND EFFECTIVENESS OF SCHEME.) NZ WARNED, HOWEVER, THAT LIMITED OFFICIAL USE

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INCREASINGLY SEVERE AGRICULTURAL PROTECTIONISM AND/OR REFUSAL OF STRONGER OECD COUNTRIES TO ACCEPT CURRENT ACCOUNT DEFICITS COULD WELL FORCE NZ TO TAKE RESTRICTIVE MEASURES WHICH WOULD HARM FOREIGN SUPPLIERS.

6. DOMESTIC OUTLOOK: NZ UNDERLINED SIGNIFICANT DOMESTIC COSTS OF CURRENT ACCOUNT ADJUSTMENT, STRESSING THAT SINCE OCT 1974 REAL WAGES HAVE FALLEN BY 10-11 PERCENT, THAT GNP LIKELY TO FALL BY 2 PERCENT OR MORE IN NZ FISCAL YEAR 1976 (MARCH 76 - MARCH 77). SECRETARIAT COMMENTED THAT NZ WAS ALSO PAYING THE PRICE FOR DEMAND MANAGEMENT POLICY EXCESSES OF 1973, AND EMPHASIZED NECESSITY FOR NZ TO CONTINUE VIGOROUS ENFORCEMENT OF EXISTING WAGE AND PRICE CONTROLS. NZ INDICATED NZG INTENTION TO CONTINUE WAGE FREEZE FOR REMAINDER OF 1976, AND NOTED THAT WHILE LABOR COULD APPEAL TO RECENTLY-CREATED TRIBUNAL TO REQUEST EXEMPTIONS TO THIS RULE, THE TRIBUNAL'S GUIDING PRINCIPLE IN GRANTING EXCEPTIONS WOULD BE OVERALL ECONOMIC STABILITY OF THE COUNTRY. IN NZ VIEW, WAGE INCREASES IN 1976 UNLIKELY TO EXCEED PROJECTED RISE IN

CONSUMER PRICES FOR THE YEAR (16-17 PERCENT; SECRETARIAT AGREED, BUT PROJECTS INFLATION RATE OF 18 PERCENT). NZ AND SECRETARIAT AGREED THAT LINGERING EFFECTS OF NZ DOLLAR DEVALUATIONS AND OF REMOVAL OF PUBLIC SUBSIDIES HAD BROUGHT ABOUT TEMPORARY ACCELERATION OF INFLATION IN FIRST HALF OF THIS YEAR, BUT THAT COMBINED EFFECT OF WAGE AND PRICE CONTROL AND DEMAND MANAGEMENT POLICY RESTRAINT WOULD LOWER RATE OF INFLATION TO 10 PERCENT ANNUAL RATE BY END 1976.

7. SEVERAL DELS OBSERVED THAT DESPITE WAGE RESTRAINT, INCREASED UNIT LABOR COSTS RESULTING FROM DECLINE IN PRODUCTIVITY APPEARED TO POSE DIFFICULT TRADEOFF. RELAXATION OF PRICE CONTROLS WOULD WORSEN INFLATION, WHEREAS MAINTENANCE OF STIFF CONTROLS WOULD REDUCE PROFITS AND INVESTMENT. NZ RESPONDED THAT PRICE CONTROLS DID NOT APPLY TO EXPORTS AND HENCE THAT PROGRAM WOULD STIMULATE NECESSARY DIVERSION OF RESOURCES TO EXTERNAL SECTOR. MOREOVER, THEY NOTED THAT PRICE CONTROL REGULATIONS CONTAIN PROVISION ALLOWING PRICE INCREASES TO EXCEED GUIDELINES IF RESULTING PROFITS ARE RE-INVESTED. LIMITED OFFICIAL USE

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8. NZ GAVE DETAILED EXPOSITION OF RECENTLY INSTITUTED PROGRAMS TO CONTROL INCOMES OF MEAT, WOOL AND DAIRY FARMERS, AND STATED THAT EFFECT OF SCHEMES WOULD BE TO SIGNIFICANTLY REDUCE DOMESTIC IMPACT OF FLUCTUATIONS IN EXPORT RECEIPTS. (SECRETARIAT AGREED.) NZ ADDED THAT CONTINUED MODERATION ON PART OF LABOR COULD NOT BE EXPECTED UNLESS AGRICULTURAL INCOMES WERE ALSO CONTROLLED.

9. FISCAL AND MONETARY POLICY: NZ STRESSED THAT DEMAND MANAGEMENT POLICY WOULD AIM AT ACHIEVING DOMESTIC STABILITY AND REDUCTION OF CURRENT ACCOUNT DEFICIT. THEY INDICATED THAT SOME PROGRESS HAD BEEN MADE IN REDUCING BUDGETARY DEFICIT, BUT THAT SIGNIFICANT FURTHER REDUCTIONS COULD NOT BE EXPECTED QUICKLY. IN THIS CONNECTION, NZ AGREED WITH U.S. SUGGESTION THAT THEY COULD ILL AFFORD THE LOSS OF FISCAL FLEXIBILITY WHICH WOULD RESULT FROM OFFERING TAX CONCESSIONS IN RETURN FOR MODERATION IN DEMANDS FOR NOMINAL WAGE INCREASES. EDRC DID NOT DISCUSS NZ MONETARY POLICY STANCE, BUT NOTED FAVORABLY RECENT NZ DECISION TO DECONTROL INTEREST RATES. EDRC CONCLUSION WAS THAT DEMAND MANAGEMENT POLICY (SUPPLEMENTED, AS APPROPRIATE, BY INCOMES POLICY) SHOULD PLAY LEADING ROLE IN PUTTING NZ BACK ON PATH OF NON-INFLATIONARY GROWTH.

10. POINTS RAISED PARAS 2, 3 AND 4 REF B ADDRESSED  
PARAS 6, 7, 9, AND 4.  
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